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TAGS: BEXP EFIN ETRD EINV EXIM EAIR ECON SENV OECD KCOR
CH, IN, BR, IS, SF, SI

SUBJECT: OECD/Export Credits: Debt Sustainability Agreement Adopted; Local Cost Financing Increased

Ref: A) 2007 Paris 2096; B) 2007 Paris 2162; C) 2007 Paris 2364

¶1. (SBU) Summary: The Members of the Organization for Economic Cooperation and Development's (OECD) Working Party on Export Credits and Credit Guarantees (ECG) and the Participants to the Export Credit Arrangement (Participants) held their semi-annual plenary sessions and Aircraft Sector Understanding (ASU) meetings in Paris on November 5-9, 2007. The ECG Members negotiated a set of Principles and Guidelines to Promote Sustainable Lending Practices based on the IMF and World Bank Debt Sustainability Framework Initiative with non-member country (NMC) representatives from China, Brazil and South Africa in attendance. The Members adopted, ad referendum, the final draft of the sustainable lending principles on January 4, 2008. In addition, the ECG approved a survey on environmental practices, and finalized a survey on measures to combat bribery. In their meetings, the Participants agreed to increase the amount of local costs export credit agencies (ECAs) can finance from 15 percent to 30 percent. The ECG and Participants met jointly with Civil Society Organizations to brief them on the full range of issues being discussed in the ECG and Participants. ECA Watch, an NGO, staged a pre-organized walk-out (45 minutes after the scheduled ending of the meeting). The Participants to the new Aircraft Sector Understanding (ASU) approved in July 2007 (Ref. B) agreed to further clarifications. End Summary.

Background

¶2. (U) Although the Export Credit Arrangement is not an official Act of the OECD, the OECD has served as the Secretariat for the Participants since the Arrangement's inception in 1978. The Arrangement sets the most favorable terms that may be provided by ECAs to their exporters, thus ensuring a "level playing field" for

exporters and avoiding export financing subsidies, except in cases where provided as genuine aid (35 percent or greater grant element).

¶3. (U) The OECD Council originally adopted the Recommendation on Common Approaches on the Environment and Officially Supported Export Credits in December 2003. The ECG agreed on June 2007 to update environmental standards on the Common Approaches for projects receiving official export credit agency (ECA) support (Refs. A and C) partly in response to the International Finance Corporation's (IFC's) development of new performance standards. End Background.

Debt Sustainability Addressed by ECG

¶4. (SBU) At the request of several of the ECG Members and the World Bank and IMF, the ECG decided to expand its policy of not supporting unproductive expenditures to all World Bank/International Development Association-Only ("IDA-only") countries. The ECG put forward a proposal for the Members to adopt a set of "Principles and Guidelines to Promote Sustainable Lending Practices in the Provision of Official Export Credits to Low Income Countries (LICs)" based on the World Bank and IMF Debt Sustainability Framework Initiative. Representatives from the World Bank and IMF discussed the merits of the proposal and the difficulties with implementation as written. After exchanging views, the ECG Members revised the proposal several times to reflect various concerns. Several Participants (Germany, Denmark, Austria, Spain and Japan) reserved the right to make comments on the final document up to November 30, 2007. After incorporating comments into the final draft on December 13, the Chairman declared the final version approved on January 4, 2008.

¶5. (SBU) The debt sustainability guidelines and principles are meant to mirror Participants' existing agreements with the World Bank and IMF regarding lending to LICs. The Statement of Debt Sustainability Principles is as follows (begin statement):

¶A. The financial environment for low-income countries has changed significantly over the past few years. Thanks to increased official financing flows, successive rounds of debt relief, favorable commodity markets and the impact of financial globalization, external financing opportunities - including non-concessional official export credits - for low-income countries (LICs) have both expanded and diversified. While this is welcome, history shows that borrowing booms can end up hindering development if resources are not well used.

¶B. Although debt relief has significantly reduced debt ratios in many LICs, many other economic circumstances remain largely unchanged and these countries face real challenges in terms of budgetary, project, and debt management capacities. Most outlays related to the Millennium Development Goals (MDG) do not, by nature, generate sufficient cash flow to the government in the near term to service official non-concessional debt. Accordingly, Members of the ECG acknowledge that concessional lending generally remains the most appropriate source of external finance for most LICs.

¶C. Bearing the above in mind, ECG Members agree that the provision of official export credits to public and publicly guaranteed buyers in LICs should reflect Sustainable Lending practices (i.e., lending that supports a borrowing country's economic and social progress without endangering its financial future and long-term development prospects). In consequence, such lending should generate net positive economic returns, foster sustainable development by avoiding unproductive expenditures, preserve debt sustainability and support good governance and transparency.

¶D. In order to promote coherent government policies as donors and as shareholders of international financial institutions and to ensure that official export credits to LICs are consistent with Sustainable Lending practices, ECG Members agree to apply the following principles to obtain reasonable assurances that their commercial lending decisions are not likely to contribute to debt distress in the future in relation to any official export credit with a repayment term of one year or more:

a. ECG Members will observe any applicable minimum concessionality

requirements of LICs to the IMF and to International Development Association (IDA); these requirements are intended to help reduce debt distress risks. Countries subject to the concessionality policy of IDA include all IDA-only countries which are receiving grants from IDA, i.e. countries that are at moderate or high risk of debt distress according to IMF/World Bank Debt Sustainability Analysis (DSA), in addition to IDA-only countries which have benefited from the Multilateral Debt Relief Initiative. Concessionality requirements are a standard feature of IMF-supported programs and apply to all sectors of activity.

- A consolidated list of countries that are currently subject to concessionality requirements from the IMF and/or IDA will be made available to Members. This list is subject to change, and will be updated regularly.

- As a result, Members will provide support for non-concessional credits only in as far as this will allow borrowers (to continue) to meet the relevant concessionality restrictions requirements. To help with this process, the IMF and the World Bank have established dedicated mailboxes to channel inquiries on their concessionality requirements by ECG members, and quick responses would be expected.

b. For those IDA-only countries without concessionality requirements to the IMF and to IDA, ECG Members agree that the provision of official export credits should take into account the results of the most recent IMF/World Bank country-specific debt sustainability analyses (DSAs) conducted within the joint Debt Sustainability Framework.

c. Good governance is a key ingredient of sustainable development while transparency reduces the risks of misuse of public resources. ECG Members will seek assurances from government authorities in the buyer country for any transaction involving a public or publicly guaranteed buyer in a IDA-Only country or a country with an IMF concessionality requirement with a credit value exceeding SDR five million and a repayment term of two years or more that the project/expenditure is in line with the country's borrowing and development plans (e.g. consistent with its Poverty Reduction Strategy Paper [PSRP] and/or the budget) following the procedures set forth by the national legislation (e.g. Parliament approval, where required). In line with previous principles, ECG Members also will refrain from providing support for unproductive expenditures. In terms of transparency, ECG Members will continue to:

- provide data on transactions supported to IDA-Only countries for review on an annual basis, in order to assess ECG Members' success towards ensuring that official export credits to low-income countries are consistent with the aims of the Debt Sustainability Framework for these countries, and

- via the OECD Secretariat, such data will be shared with the IMF and World Bank staffs on an ongoing basis.

¶E. ECG Members stress that the Principles will bring their full benefits only if all creditors act in broad harmony together. In this regard, ECG Members invite non-OECD Members to adopt these principles and to participate in further discussions and the ongoing review of experience in their application. In addition, ECG Members agree to share and discuss information amongst themselves, the World Bank and the IMF and any non-OECD Member who applies the principles on their implementation and any problems raised by possible non-adherence to them. ECG Members call on the IMF and the World Bank to pursue their own outreach efforts to non-OECD Members and private creditors to ensure that their lending practices are consistent with debt sustainability. (End Statement)

¶6. (SBU) During the meetings, several of the Participants, especially Germany, called for NMC support prior to the ECG adopting any agreement on debt sustainability. The NMCs in attendance actively participated in the discussion. While voicing support, NMCs made no commitments to the debt sustainability principles. The guidelines specifically call for the ECG through the Secretariat and the IMF/World Bank to reach out to NMCs to encourage their ECA acceptance of debt sustainability. The ECG secretariat plans meetings in February with several NMCs to ask for their acceptance of debt sustainability.

Proposal to Increase Financing of Local Costs Approved
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¶7. (SBU) The Canadian delegation reintroduced a proposal to increase local cost support by an additional 15 percent, which would enable ECAs to finance 85 percent of the export value of the contract plus up to 30 percent for local costs. Many of the ECAs from smaller members have been pressing for more liberal local cost rules and this proposal had been tabled since the April Plenary Meeting. The U.S. delegation noted that increasing support for capital goods that would otherwise have been U.S.-sourced remains a very sensitive issue since it raises budgetary costs while reducing the amount of exports financed. The OECD's Business and Industry Advisory

Committee (BIAC), voiced its support for a liberalization of the OECD local cost rules. AFL-CIO representative Owen Hernstadt responded, warning Participants of negative impacts the change would have on their own domestic economies from reduced exports. The proposal was widely supported by the all of Participants.

¶8. (SBU) Several Participants stated that there is a growing financing gap between OECD and non-OECD countries, with non-OECD countries offering longer terms, lower rates, and not applying any anti-bribery, environmental or debt sustainability standards. Non-OECD ECAs were mentioned as applying the minimum WTO anti-subsidy standards and as not providing any caps on financing local costs in support of their exports. The U.S. delegation proposed adopting the proposal on a 3-year trial basis, with additional reporting on the nature of local costs exceeding 15 percent, which was accepted. A separate survey will be conducted on the treatment of Value Added Taxes and local duties as local costs. Comment: Ex-Im Bank receives few requests to finance local costs beyond 15 percent. However, organized labor considerations may not permit Ex-Im Bank to increase its capacity to finance local costs beyond 15 percent, creating a possible future competitive disadvantage for U.S. exporters. End Comment.

ECG Participants Consult with ECA Watch

¶9. (SBU) The Participants and ECG held a consultative meeting with the OECD's Business and Industry Advisory Committee (BIAC), Trade Union Advisory Committee (TUAC), and 10 NGOs (mainly environment focused) under the umbrella name ECA Watch. ECA Watch had issued a series of letters to the ECG prior to the meeting expressing the views that: the ECG's environmental policy lacks coherence, the ECAs ignore environmental concerns in project selection, the ECG lacks a peer review system for environmentally sensitive projects, the ECG Members are inconsistent in their adherence to environmental and anti-bribery and corruption policies, and the Participants are also non-compliant with WTO trade subsidy requirements that ECAs operate at least on a break-even basis. The Secretariat addressed each of these issues in letters prior to the meeting.

¶10. (SBU) During the meeting, ECA Watch members spent less time pursuing their written complaints and focused on individual Members' projects they find objectionable, specifically the Ilisu Dam hydroelectric project in Turkey and the Sakhalin II oil and gas project in Russia. Members tried to keep the discussion to more general environmental concerns but the Austrian delegation specifically addressed the logic behind the approval of the Ilisu Dam project. The discussion was unusually open and engaged. After the meeting had run over by one hour, ECA Watch walked out in protest over a stated lack of willingness of the Members to include ECA Watch member input in their lending decisions. A "letter of regret" from ECA Watch was delivered to the ECG 40 minutes after the meeting ended, making the walk-out appear particularly staged.

¶11. (SBU) The ECG Chairman drew four conclusions from the meeting. The Secretariat will look at peer review mechanisms similar to other OECD committees for ECA projects with significant environmental concerns. ECG Members should deepen bilateral contacts with NGOs in capitals. The ECG's environmental practitioners can engage NGOs at a technical level to build a body of experience in implementing the OECD Recommendation on the environment and export credits. ECG members should continue dialogues with ECA Watch members at the national and OECD levels.

Environmental Survey - Member Comments

¶12. (SBU) In June 2007, the OECD Council adopted a Revised Council Recommendation on Common Approaches on the Environment and Officially Supported Export Credits on enhanced measures for reviewing the potential environmental impact of projects supported with official export credits. Members discussed proposals for changes to the ongoing survey of their environmental policies and practices to reflect the provisions of the Recommendations with the intention of finalizing the survey before the end of the year. Members will be asked to complete the survey by February 2008 and a report will be prepared for the April 2008 plenary meeting, after which the responses will be made available on the OECD website. The IFC reported progress on the implementation of its environmental and social Performance Standards (which are specified in the Recommendation).

Anti-corruption Survey Finalized

¶13. (SBU) In December 2006, the OECD Council adopted a Recommendation on Bribery and Officially Supported Export Credits. Members finalised and completed a revised Survey on their policies and practices with regard to anti-bribery measures. Members discussed their responses to the review and these have been made available on the OECD website.
¶14. (SBU) In a related event, Brazil (which is not a member of the OECD but is a participant in the ASU) accepted the Recommendation on Bribery and Officially Supported Export Credits as it applies to aircraft finance. Brazil also agreed to provide information and participate in surveys as they apply to civil aircraft.

ASU - Further Agreements and Clarifications Reached
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¶15. (SBU) The Participants to the Aircraft Sector Understanding (ASU) met in Paris at the OECD for their first substantive discussions following the implementation of the revised ASU in July
¶2007. During the meeting, the Participants to the ASU (Australia, Brazil, Canada, European Community, Japan, Korea, New Zealand, Norway, Switzerland and the United States) reviewed the first months of operation of the new ASU and expressed general satisfaction with the implementation process. The Participants also held a first discussion on possible enlargement of participation in the ASU in the light of the production by Russia and China of regional jets, as well as on the first review of the ASU scheduled for 2008.

¶16. (SBU) The Participants also discussed a number of technical questions relating to the interpretation of the ASU in order to clarify some outstanding issues. They were informed of views submitted by the Aviation Working Group requesting clarification on a number of points in the ASU. The US and Canadian delegations raised several points for clarification as well. The most controversial point was Canada's request, supported by the United States, to eliminate or report ex post borrower risk rating reporting requirements for transactions under $10 million in order to speed up loan approval times. The Brazilian delegation strongly objected, citing the possibility of stringing together a series of small transactions to the same borrower without reporting to the other participants. A compromise of $5 million in aggregate to one borrower on a one-year trial basis was agreed using an expedited risk rating procedure. The US delegation proposed allowing used Category 1 aircraft over 15 years old to be financed under the ASU for 5-year terms, same as under the old ASU and Category 2 and 3 aircraft under the new ASU. The EC delegation stubbornly objected, killing the proposal. Comment: Refurbished aircraft can be financed under the new ASU for 5-year terms. Since most used aircraft over 15 years old are refurbished prior to resale, the US delegation did not continue to press for approval. End Comment.

Tied Aid Data Demonstrate Rules' Effectiveness
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¶17. (U) On tied aid flows, the Secretariat reported that "Helsinki-type" tied aid (financing with at least a 35 percent grant element, for non-commercially viable projects, and subject to country limitations -- that may be tied to exports, but must be notified) dropped 20 percent in the first half of 2007 to SDR 1.2

billion, with largest donors being Spain, the Netherlands, and Austria. Largest recipients were China, Morocco, and Sri Lanka. The U.S. delegation lauded the data as further evidence of the effectiveness of the Helsinki tied aid rules, which the U.S. considers to be one of the group's greatest accomplishments.

Untied Aid Transparency Continues

¶18. (U) On untied aid, the Secretariat reported that flows increased 50 percent to SDR 6.0 billion in the first half of 2007, with Japan as the largest donor accounting for 90 percent. Largest untied aid recipients were Iraq, Vietnam, and India. The Secretariat also noted that the group's untied aid transparency exercise continues through the end of 2008. Ninety-nine percent of contracts were awarded using International Competitive Bidding procedures, resulting in 39 percent of contracts award to recipient country firms, 32 percent to donor country firms and 29 percent to firms from other countries. The U.S. delegation affirmed the value of the exercise and noted that it continues its efforts to disseminate procurement opportunities to U.S. firms.

¶19. (U) This cable has been cleared by delegation participants.

EGAN